

## Better Estate Planning

### GIFTS AND TRUSTS: EFFECTIVE ESTATE PLANNING TOOLS

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*Estate Planning attempts to create an equitable compromise between minimizing the amount of taxes due, distributing the property as desired to the designated heirs and assuring a financial source of security.*

*This fact sheet on Gifts and Trusts: Effective Estate Planning Tools in Texas was prepared by Eugene M. McElyea, L.L.B., College of Business, Texas A&M University and consultant to the Texas Agricultural Extension Service program for this series of fact sheets on Estate Planning.*

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When and how can a person most economically give his estate to preferential persons? Every effective estate plan strives to answer these questions. Planning the distribution of one's accumulations at minimal cost assuring maximum security during life and disposition of one's property at or before death, is the prime goal of estate planning.

An estate will be distributed at death, whether by will or otherwise, but waiting until death to dispose of one's assets may not be as economical as making some planned distributions *during* one's life.

Making a gift offers certain tax benefits when one considers estate tax. However, the federal government created a federal gift tax law and has sought to prevent persons with large estates from avoiding estate tax by giving lifetime gifts.

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While many persons make lifetime gifts with taxes in mind, there is a great, intangible reward to giving. This occurs when the donor sees the donee enjoying the benefits of a gift. For many this satisfaction far outweighs the tax benefits or even the tax costs connected with giving.

A gift tax cost, if applicable, is at a rate which on the average would be three-fourths the rate assessed on the equivalent amount by estate taxes. To determine whether or not a gift is taxable, the following guidelines apply:

- All gifts in 1 calendar year to any one person are tax free if they do not exceed \$3,000.
- All gifts over \$3,000 are reportable on a U.S. Gift Tax Return by April 15 of the year following the gift. Even gifts to charity must be reported, although such gifts are tax exempt.
- Each person has a lifetime gift tax exemption of \$30,000.
- A person may make as many \$3,000 or smaller gifts in 1 year to as many different persons as he desires or has resources. The gifts are tax free and no gift tax return is necessary.
- The \$30,000 lifetime is used up in the following manner. A total gift of \$18,000 in 1 year to one individual necessitates a tax return. To the extent such gift exceeds \$3,000 it reduces the lifetime exemption. Fifteen thousand dollars is subtracted from \$30,000 leaving only \$15,000 unused. A second gift of \$18,000 to another would erase the entire \$30,000 (\$18,000 less \$3,000 equals \$15,000; \$15,000 less \$15,000 equals zero). Gifts which

use up the exemption are tax free. Once the exemption is depleted, all gifts over \$3,000 are taxable on the amount in excess of \$3,000. For example, a gift of \$8,000 after the two previous gifts would be taxable. Tax on \$5,000 of that gift at current rates would be \$112.50.

- A husband and wife would each have a \$30,000 lifetime exemption giving them a double, tax-free, gift capacity over a single individual. In 1 year a married couple with five married children could divide to each child and his spouse, if neither had made any previous gifts over \$3,000, the total sum of \$120,000 tax free. Such a gift would use up the lifetime exemption of both spouses.

From these guidelines it can be seen that the gift tax falls most heavily on large gifts to small numbers of people. Small gifts to large numbers of people are encouraged by lower taxes or by none at all.

The following rate schedule shows the applicable tax on any taxable gift:

#### GIFT-TAX SCHEDULE

The rates above exemptions and exclusions are:

First \$5,000 or any part thereof	2.25 percent
Next \$5,000 or any part thereof	5.25 percent
Next \$10,000 or any part thereof	8.25 percent
Next \$10,000 or any part thereof	10.50 percent
Next \$10,000 or any part thereof	13.50 percent
Next \$10,000 or any part thereof	16.50 percent
Next \$10,000 or any part thereof	18.75 percent
Next \$40,000 or any part thereof	21.00 percent
Next \$150,000 or any part thereof	22.50 percent

The gift tax on amounts above exemptions and exclusions is:

Amount	Tax	Amount	Tax
\$ 5,000	\$ 112.50	\$ 50,000	\$ 5,250
\$10,000	\$ 375.00	\$ 60,000	\$ 7,125
\$20,000	\$1,200.00	\$100,000	\$15,525
\$30,000	\$2,250.00	\$200,000	\$38,025
\$40,000	\$3,600.00		

While gifts have an advantage of reducing the gross estate at death and lowering the amount subject to death taxes, there are other aspects to consider before embarking upon a program of systematic giving. A gift is a transfer surrendering complete control over the item or money given. A gift with strings attached is not a gift.

Gifts reduce capital and when a donor is still active in accumulating an estate, a gift program might not be good business. This decision is

important when considering one's particular circumstances. Another problem arises when a gift is not wisely used in the manner the donor prefers. If a gift is to be wasted and squandered, one might not wish to give it.

An outright gift has tax advantages, but the possibility of misuse is also a distinct disadvantage. By what method can a gift be made whereby some sound judgment governs its use? Trusts offer a way to achieve wise, long-range and short-range disposition to an estate owner's descendants. A trust can be as flexible or as rigid as the estate owner desires. Trusts are the estate planner's most versatile tools.

A trust is nothing more than an agreement between the maker and the trustee whereby the maker delivers property to the trustee to hold and use that property as the maker has directed for the maker's benefit or for the benefit of third parties. The right to benefit from property is separated from the right to exercise control over it by means of a trust. A trust is often the only or best method of accomplishing a variety of objectives.

In establishing a trust, the maker can retain the right to later change or amend the trust agreement. This type of trust is a "revocable" trust. An irrevocable trust is one which the maker gives up all right to modify or alter the agreement. Trusts can be created in a will—and while they are revocable in a will during life—they become irrevocable at death.

A trust provides numerous benefits. Among them are:

- Obtain various tax benefits.
- Assure proper management of estate property.
- Arrange preferred distributions to beneficiaries during life and at death.
- Postpone delivery of gifts.
- Create a regular source of income during life for the maker.
- Give a gift to charity.

Ways to devise a trust are limitless. Some of the more common types and some of their basic provisions include the "inter vivos" or "living" trust, the insurance trust and differing types of income and gift trusts.

An "inter vivos" trust or living trust is created during life. Certain types of revocable living trusts are proclaimed as surefire ways of avoiding the pains of probate court with its alleged, unreasonable costs and frustrating delays. In such a trust

when the maker dies, a pre-arranged distribution plan becomes operative avoiding the passage of one's estate property through probate court channels.

For estate tax purposes, it makes no difference whether property is in trust or not. If the deceased person is able to maintain any degree of control and direction over the principal then the property in a trust is considered property which the deceased owned at death and subject to tax. Each trust must be carefully analyzed and those trusts having provisions which place property effectively beyond the reach of the maker and which are irrevocable, generally accomplish the purpose of avoiding estate taxes. When large sums are used to create a trust, it is possible that at the original funding of a trust, a federal gift tax might become payable.

A life insurance trust is created by life insurance proceeds paid at death. Purpose of this trust is to protect a surviving spouse from a windfall of insurance money and having perhaps limited ability to wisely conserve and manage it. This type of trust acts to defer the delivery of insurance proceeds in order that it might serve the purchaser's original purposes.

Since a trust is as flexible as the human mind, it is possible to create arrangements that provide income and security for as long as one lives. All tax involvements in these arrangements must necessarily be determined in the individual situation. A tax consultant can best advise the effect in a particular case.

The danger in creating a trust occurs when one ties up assets too tightly. To be strait-jacketed in a rigid, trust situation can be unpleasant and unwise. The amount committed to a trust arrangement is a financial decision made in light of one's

resources and consistent with sound business practices.

Who shall act as trustee? The best trustee is someone or some banking organization that is trustworthy. A trust will never fail for lack of a trustee, but most trusts provide for successor trustees when the originally designated trustee fails to serve. If no substitute is designated, a court will name a trustee. This may be an unsatisfactory arrangement when a trustee is required to exercise a great deal of discretion.

A corporate trustee, like a corporate executor, offers the estate owner experienced management, solvency and continuity. While these are worthy benefits, appointing an individual trustee may prove highly satisfactory.

There are lawful methods to minimize tax and save costs. Prudent use of gifts and trusts represents a satisfactory solution to major estate planning problems. Estate planning may not eliminate all costs or taxes due in a particular estate, but it is exceedingly preferable to inaction in planning financial matters. Estate planning pays big dividends to the estate owner and to survivors. It is good business management to consider the future now.

*This publication is designed to provide accurate and authoritative educational information in regard to the subject matter covered.*

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## SUGGESTED READINGS

Listed below are additional Extension fact sheets on Estate Planning.

- L-950 The Importance of a Will in a Texas Estate**
- L-951 Texas Laws on Descent and Distribution**
- L-952 Community and Separate Property in Texas**
- L-953 Costs of an Estate in Probate**
- L-954 Charitable Gifts**
- L-955 Federal Estate and State Inheritance Taxes**